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58370—34

In the Supreme Court of the United States

OCTOBER TERM, 1933

No. ——

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

UNION PACIFIC RAILROAD COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered in the above cause on February 20, 1934, affirming in part and reversing in part a decision of the Board of Tax Appeals. This petition is intended to be limited to the single question stated below.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 41) is reported in 26 B.T.A. 1126. The opinion of the Circuit Court of Appeals (R. 97) is reported in 69 F. (2d) 67. The part of the opinion of the Board of Tax Appeals dealing with the question here sought to

be reviewed commences at R. 52 and that of the Circuit Court of Appeals at R. 101.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 20, 1934 (R. 103). A petition of the taxpayer for rehearing was denied March 14, 1934 (R. 104–105). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer kept its books on the accrual basis, and it and the Oregon Short Line Railroad Company made consolidated returns. The taxpayer and the Oregon Short Line had both marketed issues of bonds prior to 1913, and in that connection had incurred and paid commissions to bankers. May the current year's proportion of the amortization of these commissions be subtracted in determining taxable net income in 1920, 1921, 1922, and 1923?

STATUTES AND REGULATIONS INVOLVED

These are set out in the Appendix, *infra*, pp. 9–10.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 52) may be summarized as follows:

Prior to 1913 the Union Pacific Railroad Company and its subsidiary, the Oregon Short Line, sold three issues of bonds at varying rates of discount, and in connection with the sales paid commissions to bankers. The railroads claimed deductions in the taxable years

1920, 1921, 1922, and 1923 for these discounts and commissions, amortized over the life of the bonds. The aggregate amount of the deductions claimed each year on account of discounts was $251,896.55, and on account of commissions, $57,252.57 (R. 52). The issues of bonds, the commissions paid, and the amortization of commissions, as shown by the petition to the Board of Tax Appeals, the allegations of which on this point were admitted by the answer (R. 41), were as follows:

In 1904 the Oregon Short Line sold an issue of Refunding bonds maturing on December 1, 1929, upon which it paid commissions amounting to $960,000.00, which, amortized over the twenty-five-year life of the bonds, gives $38,400.00 as the yearly amortization of commissions (R. 23, 24, 52).

In 1907 the Union Pacific sold an issue of Twenty-Year Convertible bonds upon which it paid commissions amounting to $134,176.00, which, amortized over the twenty-year life of the bonds, gives $6,708.80 as the yearly amortization of the commissions (R. 19, 20, 52).

In 1908 the Union Pacific sold an issue of First Lien and Refunding bonds maturing in 2008, upon which it paid commissions amounting to $1,214,377.16, which, amortized over the one-hundred-year life of the bonds, gives $12,143.77 as the yearly amortization of the commissions (R. 21, 52).

The Board of Tax Appeals decided that the taxpayer was entitled to the deductions claimed on account of bond discount, but not on account of

commissions. (R. 52–53.) As to the commissions, the taxpayer appealed to the Circuit Court of Appeals, which reversed the Board of Tax Appeals. (R. 101–103.)

SPECIFICATION OF ERRORS TO BE URGED

1. The Circuit Court of Appeals erred in holding that the taxpayer could deduct the amortized commissions on bonds issued prior to 1913.

2. The Circuit Court of Appeals erred in holding that the commissions paid on bonds issued prior to 1913 are losses within the meaning of Section 234 (a) (4) of the Revenue Acts of 1918 and 1921, that they will not be suffered until the bonds mature, and that they may be amortized over the life of the bonds.

3. The Circuit Court of Appeals erred in reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision below is in conflict with the decision of the Circuit Court of Appeals for the Seventh Circuit in *Chicago, R. I. & P. Ry. Co.* v. *Commissioner*, 47 F. (2d) 990, certiorari denied, 284 U.S. 618. In that case, the taxpayer sold, prior to 1913, bonds maturing in 1934. The expenses of selling the bonds, which amounted to about $250,000, were charged to profit and loss on the dates of sale. The taxpayer claimed a prorated expense deduction for the years 1916 to 1919, inclusive, for the cost of issuing and selling the bonds, but the court held that the taxpayer was not entitled to the deduction. While the precise nature of the expenses, and whether

they included commissions, does not appear, the general nature of the expenses was similar to those involved in the present case, but the two courts reached opposite results.

2. The question presented is of considerable general importance. Many bond issues of railroads and other corporations, marketed before 1913, are still outstanding, and in the case of many of them commissions were paid to bankers when the bonds were sold. The question whether such commissions may be amortized, and the current year's proportion deducted from gross income, arises each year in the case of each such taxpayer.

3. The decision below is believed to be erroneous. The question arises under the Revenue Acts of 1918 and 1921. Section 234 of each of those Acts (*infra*, p. 9), like corresponding provisions of the Acts before and since, allowed deduction of expenses paid or incurred, interest paid or accrued, and losses sustained, during the taxable year. These commissions, whether regarded as expenses, extra interest, or losses, were incurred and paid in 1904, 1907, and 1908, and it is only by a fiction of accounting that any part of them can be regarded as falling in any of the years 1920–1923.

It is perfectly true that such commissions substantially resemble discounts on bonds sold, which are in turn the converse of bond premiums. It is also true that when such items, whether premium, discount, or commission, upon a bond issue having several years to run, are wholly charged or credited to

income in a single year, the income account for that year is distorted. For that reason the regulations of the Treasury Department (*infra*, p. 9) under the Revenue Acts of 1918 and 1921 provided that both bond discount and bond premium should be amortized over the life of the bonds. While the regulations were silent as to commissions paid to bankers, and other like expenses, the Treasury rulings show that they were treated, at that time, like discounts. O.D. 936, 4 Cumulative Bulletin 276; O.D. 959, 4 Cumulative Bulletin 129; I.T. 1412, I–2 Cumulative Bulletin 91; I.T. 1962, III–1 Cumulative Bulletin 291; S.M. 3691, IV–1 Cumulative Bulletin 145.

Before the decision of this Court in *Old Colony Railroad Co.* v. *Commissioner*, 284 U.S. 552, these rules were applied alike to premium, discount, and expense, whether the securities were issued before or after March 1, 1913. They are still so impartially applied when the securities were issued after that date, as the decision in the *Old Colony Railroad* case permits. 284 U.S. 552, 558; Regulations 77, Article 68, *infra*, p. 10. But in respect of securities put out before the income tax became effective, recent decisions, of which the present case is one, have resulted in a difference of treatment, and in inequality.

Under the decision in *Old Colony Railroad Co.* v. *Commissioner*, *supra*, premiums received before March 1, 1913, may not be prorated to later years. The Board of Tax Appeals had held, before this Court's decision in that case, that discounts suffered on sales before that date must be prorated (*C., R. I. &*

P. Ry. Co. v. *Commissioner*, 13 B.T.A. 988, 1027–1034; see also *Western Maryland Ry. Co.* v. *Commissioner*, 33 F. (2d) 695, 696–697) (C.C.A. 4th); and it has in this case followed the same rule, and the Circuit Court of Appeals has held the same as to commissions. As to premiums and discounts, the regulations have been amended to conform to these divergent holdings. Regulations 77, Art. 68, *infra*, p. 10. But the plain fact is that neither discounts nor commissions differ in principle from premiums. The only difference is that the shoe is on the other foot.

The court below was of opinion that these commissions were a "loss" and that "the loss is actually sustained when the bonds are paid or redeemed" (R. 102), when, presumably, there will still be an income tax. Such reasoning seems wholly artificial. A commission paid to bankers for floating an issue of securities is not a "loss" in any ordinary sense. It is a sum of money paid for services, which presumably are worth the payment. Such expenses are incurred when the services are rendered, and paid when the services are paid for, not twenty or a hundred years thereafter when the securities mature. If the view taken by the court below in this respect were followed, then an issuer of bonds, which became insolvent and never paid them off, would never have paid the commissions which it did pay when the bonds were issued.

The question as to discounts, taken before 1913, is not open in this case, because the Commissioner did not appeal from the adverse decision of the Board of Tax Appeals upon that point. But the question of

commissions is open, and for the reasons stated it is believed that it deserves review.

Wherefore it is respectfully submitted that this petition for a writ of certiorari, to review, upon the single question stated, the judgment of the Circuit Court of Appeals for the Second Circuit, should be granted.

J. CRAWFORD BIGGS,
Solicitor General.

MAY 1934.

APPENDIX

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077:

> Sec. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> (1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *
>
> (2) All interest paid or accrued within the taxable year on its indebtedness * * *
>
> * * * * *
>
> (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;
>
> * * * * *

Revenue Act of 1921, c. 136, Sec. 234, 42 Stat. 227, 254, contains substantially identical provisions.

Treasury Regulations 45 (1920 Ed.), under the Revenue Act of 1918:

> Art. 544. * * *
>
> (2) (a) If bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. * * *
>
> (3) (a) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. * * *

Treasury Regulations 62 (1922 Ed.), under the Revenue Act of 1921, Art. 545, contains identical provisions.

Treasury Regulations 77, under the Revenue Act of 1932:

> Art. 68. * * *
>
> (2) (a) If bonds are issued by a corporation subsequent to February 28, 1913, at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. * * *
>
> (3) (a) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. * * *
>
> (4) (a) If bonds were issued by a corporation prior to March 1, 1913, at a premium, the net amount of such premium was gain or income for the year in which the bonds were issued and should not be prorated or amortized over the life of the bonds. * * *

U. S. GOVERNMENT PRINTING OFFICE: 1934